U.S. SENATE BANKING COMMITTEE

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Statement of Chairman Dodd
Hearing on State of the Banking Industry

Remarks as prepared:

This morning, the Committee examines the state of the banking industry in our nation. Such an examination by this Committee could not be more important or timely.

It is important because our first duty as legislators on this Committee is to ensure that insured depository institutions operate in a safe and sound manner.

These institutions currently hold over $4.3 trillion in deposits that are insured by the American taxpayer.

Therefore, the taxpayer has a right to know that the appropriate agencies are ensuring that any risks to those deposits are being managed prudently and with the taxpayer's ultimate liability in mind.

I well remember sitting on this dais two decades ago with Sen. Shelby and others, cleaning up the mess caused by reckless and wanton practices in the savings and loan industry. Those practices – and the regulatory failures that allowed them to occur – required a taxpayer bailout of some $150 billion dollars.

None of us – none of us – wants to go through that kind of exercise again.

That is why this hearing is not only important, but timely, as well. Credit markets are experiencing unprecedented disruption right now. The markets for mortgages, credit cards, student loans, auto loans, corporate debt, municipal debt – in short, for all of the economic activities that are indispensable to growth and prosperity – these markets have chilled and in some cases have frozen entirely.

These markets have seized up mostly as a direct result of problems in the subprime market. Recent estimates indicate that insured depositories and other financial institutions could lose an additional 300 to 400 billion dollars due to exposure to mortgages – residential as well as commercial. It is no surprise, then, that many of these institutions have sought infusions of over $30 billion in capital, from foreign sovereign wealth funds, since November of last year.

The federally insured banks, thrifts, and credit unions of our nation are not just another group of financial intermediaries. Their success or failure is not merely of concern to their employees and shareholders. It is of concern to all of us – because these institutions in a very real sense form the cornerstone of our nation's economic foundation. If these lenders do not or cannot lend, then our economy cannot and will not grow.

President Kennedy is reported to have once said: "If the economy is wrong, then nothing is right." If that is the case, then it is no less true that, if the banking industry is wrong, then the economy is not right.

The regulatory agencies that oversee this industry therefore play an indispensable role not only in the economic activities of the lenders they oversee, but in the economic life of our nation. They do not merely apply and enforce the laws – as important as that job is. And they do not only ensure that the deposits which are insured by the American taxpayer are managed in a safe and sound manner – though they do that, as well. Fundamentally, they serve as gatekeepers of credit for the entire economy.

That is an awesome responsibility. The men and women who work at our nation's financial regulatory agencies understand that responsibility. And by and large they discharge it with diligence and distinction.

But dedication is not tantamount to infallibility. That point was made a year and one-half ago, when Senators Allard and Bunning convened hearings on irregular practices in the mortgage lending industry. I have commended them before for their efforts, and I do so again today.

The point was made again a year ago, when this Committee convened a hearing to examine the turmoil in our nation's mortgage markets. At that time, I detailed what I termed "a chronology of neglect" by federal regulators – principally the Federal Reserve under its previous leadership. We presented evidence that Federal Reserve examiners knew as far back as late 2003 of the deterioration of lending standards in the origination of adjustable rate and other non-traditional mortgages.

Yet, the Fed did nothing to intervene. On the contrary, its Chairman at the time actually encouraged such loans. Then he simultaneously embarked on a series of interest rate hikes that would make adjustable rate mortgages less affordable for homeowners.

The impact of these policies is now felt by millions of American consumers who face interest rate spikes that have led or will lead to foreclosure. It is felt by millions more who cannot obtain mortgage credit because the market for subprime and jumbo loans has seized up. It is felt by entrepreneurs who cannot obtain loans or other forms of financing because lending institutions are in a virtual credit lock-down. And it is felt by lenders themselves, who are struggling in ways that they have not struggled in recent memory. It is no wonder that the Fed's own witness at a hearing before this committee last year said that in retrospect his agency "could have done more sooner" to address predatory mortgage lending practices.

Again and again the question has been asked over the past year as our credit markets have grown increasingly impaired: Where were the regulators? Why didn't they "do more"? Were they asleep at the switch? And when the alarm went off, did they merely hit the snooze button?

Four years ago, Sen. Shelby convened an oversight hearing similar in purpose to today's. At the time, the federal agencies represented here this morning hailed innovations in risk management that enabled banks to better quantify risks and take early corrective measures to contain undue risks. They pointed to the secondary markets and newly developed structured finance products as tools that would help banks more effectively manage and diversify their risks. In the words of the then-Comptroller of the Currency, bank supervision would provide "a layer of protection against the challenges posed by our changing economy."

Four years later, we want to know: what happened to the new-fangled risk management innovations that were supposed to sound an early warning about reckless lending practices? What about the promise of securitization as a way to manage credit risk? Where was the layer of supervisory protection against excessive risk? Why didn't you more vigorously enforce good, old-fashioned, common-sense underwriting – where a loan is made based on a borrower's ability to pay it back? And what are you doing now – today – to protect against new risks posed by instruments such as credit default swaps – trillions of dollars of which are held by the institutions you regulate?

These are legitimate questions, important questions – questions that America's taxpayers have every right to ask and to have answered. We appreciate the willingness of our witnesses to appear today to help provide those answers.

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